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IN THE

Supreme Court of the United States

October Term 1951

No. 173

JOSEPH T. LYKES,
Petitioner,

VERSUS

UNITED STATES OF AMERICA,
Respondent

On Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER JOSEPH T. LYKES

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OPINIONS BELOW

The opinion of the Court of Appeals (R. 58-63) is reported at 188 F. 2d 964. The memorandum opinion of the District Court (R. 44-49) is reported at 84 F. Supp. 537.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951 (R. 58, 63).

In an order dated October 8, 1951, this Court granted the petition for certiorari filed July 5, 1951.

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code, being 28 U S C Section 1254 (1).

STATUTE AND REGULATIONS INVOLVED

The statute involved is Section 23 of the Internal Revenue Code (26 U S C Section 23) as amended by Section 127 (a) of the Revenue Act of 1942, c 619, 56 Stat 798. The applicable portion of that statute reads as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments re-

quired to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he had no equity.

* * *

(2) *Non-trade or non-business Expenses.*

—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

The Regulations of the Treasury Department here involved (Regulations 111, Section 29.23 (a) (15) have been set out as Appendix A of this Brief.

QUESTIONS PRESENTED

The petitioner contends that the Court of Appeals erred in its apparent determination that any litigation related to gift taxes necessarily means that the expenses of that litigation are not deductible under Section 23 (a) (2) of the Internal Revenue Code. The question, therefore, is:

Was the District Court correct in determining that under some circumstances litigation expenses involving gift taxes *are* deductible from income as non-trade or non-business expenses incurred in the "management, conservation, or maintenance of property held for the production of income;" and that such expenses were properly deductible under the facts and circumstances of the instant case?

The Petitioner contends that the District Court's determination was proper, and that the question should be answered in the affirmative.

STATEMENT OF THE CASE

Procedure in the Courts Below. This case was started in the United States Court for the Southern District of Florida by the filing of a complaint against the United States under Section 24 (20) of the Judicial Code as Amended (28 U S CA 41 (20)) for the refund of federal income taxes overpaid for the calendar year 1944 in the amount of $5,665.78, plus interest (R 2). After an answer which principally denied the facts (R 15-16), the case went to final hearing (R 17 et seq.). The only witnesses were the plaintiff and an accountant who testified in his behalf concerning the tax calculation.

On June 8, 1949, the District Judge filed his Memorandum Decision (R 44 et seq.) ordering judgment for the plaintiff (R 49), and Judgment pursuant thereto, dated November 14, 1949 (R 50), was filed November 15, 1949.

On Notice of Appeal filed January 14, 1950, and amended Notice of Appeal filed February 23, 1950, (R 51), the case went to the United States Court of Appeals for the Fifth Circuit, which on April 27, 1951, filed its opinion (R 58-63) and judgment (R 63) reversing the District Court.

The case is in this Court on order granting petition for certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit, dated October 8, 1951.

Statement of Facts. The facts as affirmatively found in the Memorandum Decision of the District Court are as follows (R 44-46):

The taxpayer is and has been for many years a stockholder in Lykes Brothers, Inc., a family corporation. The stock of the corporation has been closely held throughout its existence and there is not nor has there ever been an open market price for the stock. In the year 1940 taxpayer made gifts of 1,000 shares of stock of the corporation, owned by him, to members of his family, as follows (R. 44):

250 shares to Margaret K. Lykes, his wife
250 shares to Margaret H. Lykes, his daughter
250 shares to Elizabeth L. Lykes, his daughter
250 shares to Joseph T. Lykes, Jr., his son

It appears from the testimony that one of the daughters had reached her majority at the time of the gifts, but the other two children were minors. All of the children made their home with the taxpayer, were unmarried and neither the wife nor the children took any part in the management of the business of Lykes Brothers, Inc., at the time of the gifts. (R. 44.)

The motive for the gifts, as stated in the taxpayer's gift tax return, was love. The taxpayer testified to additional motives, the principal one of which was the accepted custom or policy of himself and his brothers to make such gifts to their children to insure continuity of the ownership and management of the company. The evidence shows this custom has been pursued by other members of the Lykes family. (R. 45.)

At the time the gift tax return was filed, taxpayer valued the stock at $120 per share and paid a gift tax thereon in the sum of $13,032.75. The taxpayer testi-

fied he took as a guide in determining the value of the stock the only arm's-length transaction of importance during that year of which he had knowledge—the sale of several hundred shares by an executive (not a member of the Lykes family) to other executives of the company. He testified he also took into consideration the hazards then confronting the business and reached the conclusion that the market value established by the sale represented the fair value of the stock at the time. (R. 45.)

On March 3, 1944, the Commissioner of Internal Revenue formally notified the taxpayer that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 and a deficiency in that amount was assessed against taxpayer. He also was notified of his right to petition the Tax Court for a redetermination of such deficiency liability. (R. 45.)

The taxpayer engaged K. I. McKay, an attorney at law, to represent him in this matter and a petition for redetermination of the liability was filed with the Tax Court. After taxpayer's attorney had prepared and filed such petition and prepared his case for trial, a compromise settlement was reached and the Tax Court, pursuant to stipulation of the parties, found a deficiency in taxpayer's gift tax return in the sum of $15,612.75, which was promptly paid. The taxpayer paid his attorney $7,263.83 in the year 1944 for services in this matter. (R. 45-46.)

Furthermore, the District Court found that if the payment of attorney's fees was a deductible expense from gross income for the year of payment, then the plaintiff-taxpayer (petitioner herein) was entitled to recover $5,665.78 with interest (R. 46) and ultimately gave judgment in that amount. (R. 50.)

We contend that the District Court, in finding for the plaintiff-taxpayer, necessarily found as facts the factual matters set out in the opinion as the contentions of the plaintiff-taxpayer (R. 46), namely:

The payment of attorney's fees of $7,263.83 was made, not as the result of an ordinary contest concerning the valuation of ordinary personal gifts, but that it was a payment of legal expenses incurred to forestall the collection by the Government of an assessment of a tax which was so clearly arbitrary and capricious that in fact, it had nothing to do with the gift on which it was based.

Had that tax been successfully enforced against him it would have substantially destroyed his holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income.

Furthermore, the record in this case is not long, and the evidence is uncontroverted. It is likely that the District Judge had this in mind in telescoping the factual matter developed at the trial into the compass of his short Memorandum Decision. Therefore, we consider that this Court should rely for its facts on all credible testimony developed at the trial (R. 25-26, 32-42), the general finding for the plaintiff, and the stipulated facts (R 19-21). On that basis we add the following pertinent facts as being, at a minimum, part of the statement of the case:

The petitioner (the taxpayer) did not give all of his shares away—only about one-third (R 36). Consequently, his ultimate purpose in following a plan of giving (R 33-34), was to "further fortify our *remaining* interest in company" (R 32) by bolstering the executive

staff (R 34-35). This policy of giving in order to fortify the balance of the interest in Lykes Brothers, Inc., which was retained, proved sound (R 34).

A substantial interest in Lykes Brothers, Inc., had been retained by the petitioner (taxpayer) through the time of the trial (R 37).

The payment of counsel fees which the petitioner (taxpayer) considered a proper deduction, occurred at the time of the assertion of the deficiency, and was for the immediate relief of that situation (R 37-38), and not for the successful conclusion of the Tax Court case, which occurred two years later (R 20-21).

SPECIFICATION OF ERRORS

The petitioner claims that the Court of Appeals erred in reversing the decision of the District Court; and, more specifically—

1. In refusing to give effect to the principles to be applied in the application of Section 23 (a) (2) of the Internal Revenue Code, as pronounced in *Bingham's Trust vs. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670, and other cases in this Court therein cited.

2. In refusing to uphold the decision of the District Court which denied the applicability or validity of the Treasury Department's Regulations intended to interpret Section 23 (a) (2) of the Internal Revenue Code (being Regulations 111, Section 29.23 (a) -15, and thus conflicting with the *Bingham* case and other cases decided by this Court.

3. In refusing to uphold the decision of the District Court on the facts, and thus improperly ignoring the holding of this Court in *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365, 89 L ed 1670, to the effect that the trial court's determination of whether a particular expense met the conditions of the statutory deduction was principally a question of fact (325 US at 371, 373, 376).

OUTLINE OF ARGUMENT

The argument follows the points stated in the Specification of Errors.

I. Section 23 (a) (2) of the Internal Revenue Code should be construed liberally in the taxpayer's favor.

A. Congressional enactment of that section was corrective of *Higgins vs. Commissioner,* 312 US 212; 85 L ed 783.

McDonald vs. Commissioner, 323 US at 67, 87 L ed at 75; Nahstoll, *Non-trade and Non-business Deductions,* 46 Mich L Rev, 1015, 1016, 1019.

B. The usual rule that exemptions statutes must be strictly construed *(New Colonial Company vs. Helvering,* 292 US 435, 440; 78 L ed 1348, 1352; *Commissioner vs. Jacobson,* 336 US 28, 49; 93 L ed 477, 489) must be tempered by;

1. Congressional intention to tax net income, not gross income.

McDonald vs. Commissioner, 323 US 57, 89 L ed 68, dissenting opinion by Mr. Justice Black at 323 US 67

Nahstoll, *Non-trade and Non-business Deductions*, 46 Mich L Rev at 1023

2. Corrective and liberalizing provisions in income tax laws shqulb be liberally construed in favor of the taxpayer.

Helvering vs. Bliss, 293 US 144, 150-151; 79 L ed 247.

C. Section 23 (a) (2) went beyond the immediate problem of the *Higgins* case, and should not be limited in its application to the injustice which Congress perceived was present in that case.

McDonald vs. Commissioner, 323 US 57, 89 L ed 68, dissenting opinion of Mr. Justice Black at 323 US 67.

II. Regulations 111, Section 29.23 (a) -15 (b), as interpreted by the Court of Appeals, is invalid.

A. The Court of Appeals did not properly construe the Regulations, by assuming that a mere example was interpretive of the statute, and had the force and effect of law.

B. A factual example is invalid as an interpretation of the statute.

Miller vs. United States, 294 US 435, 439-440; 79 L ed 977, 980-981.

Waite vs. Macy, 246 US 606, 609; 62 L ed 892.

Busey vs. Deshler Hotel Co., 130 F 2d 187, 190; 142 ALR 563.

C. The Regulations are invalid as in conflict with decisions of this Court which determine that the matters considered by the Regulations are factual and not matters of law.

Bingham's Trust vs. Commissioner, 325 US at 374, 89 L ed at 1677.

Kornhauser vs. United States, 276 US at 153, 72 L ed at 507.

Appeal of Sarah Backer et al, 1 BTA 214, 216.

Commissioner vs. Heininger, 320 US at 471, 88 L ed at 175.

D. The Regulations are invalid as inconsistent within themselves.

63 *Harvard Law Review* 358, December, 1949.

E. The Regulations are unreasonable in making deductions depend on the whim of the Commissioner—that is, whether he choses to assert tax deficiencies against the donor or the donees. Section 1009, *Internal Revenue Code*.

III. The Determination by the District Court was essentially on a question of fact, and it should not be reversed unless clearly erroneous.

Bingham's Trust vs. Commissioner, 325 US 365, 370, 373, 376; 89 L ed 1670.

Federal Rules of Civil Procedure, Rule 52.

United States vs. Yellow Cab Co., 338 US 338; 94 L ed 150.

A. If the Court of Appeals founds the Memorandum Decision an inadequate source for the facts, it should have dismissed or remanded.

Massachusetts Bonding vs. Preferred Automobile Insurance Co., 110 F 2d, 764 (CCA, 8, 1940).

Mayo vs. Lakeland Highlands Canning Co., 309 US 310, 319; 84 L ed 774, 780.

B. A basic distinction between the *Bingham* case and the *McDonald* case is that in the former the trial court held for the taxpayer, and in the latter *against him.*

McDonald vs. Commissioner, 323 US 57, 64; 89 L ed 68, 74.

Bingham's Trust vs. Commissioner, 325 US 365, 370; 89 L ed 1670, 1675.

C. Any questions of law in the instant case were decided in favor of the taxpayer in the *Bingham* case.

Bingham's Trust vs. Commissioner, 325 US at 371, 372, 375; 89 L ed 1670, 1675, 1676, 1677, 1678.

1. Section 23 (a) (2) is applicable to a trust only by virtue of Sections 161 and 162 of the Internal Revenue Code.

Bingham's Trust vs. Commissioner, 325 US 365, 368; 89 L ed 1670, 1674.

2. There is no distinction between the application of Section 23 (a) (2) to a trust and to the individual's income producing "estate".

Nancy Reynolds Bagley, 8 TC 130.

3. The case of *Cobb vs. Commissioner*, 173 F. 2d 711, was erroneously decided; but in any event this case and the *Cobb* case are distinguishable, not only on the basis of the different results obtained in the trial court, but on the facts.

a. The gift was not a purely personal transaction.

b. Assuming, contrary to fact, that the gift was purely personal, it was not the gift which necessitated the legal expense, but an attack against the taxpayer by the Government of such magnitude that its arbitrary and capricious nature neutralized the personal aspect of the gift as a generating cause of the legal expenses.

ARGUMENT

Statement of Points of Law

This case involves three general subjects of inquiry. We consider that these are the matters of law which are involved:

1. The construction of Section 23 (a) (2) of the Internal Revenue Code;

2. The determination of the validity of the regulations which purport to interpret that statute,

i.e. Treasury Department Regulations 111, Section 29.23 (a) -15;

3. The effect of a determination on the facts by the trial court, in this case the United States District Court for the Southern District of Florida.

There are ancillary considerations which must be examined with regard to each one of these points, e.g. the determination of the clarity with which the factual findings appear in the Memorandum Decision of the District Judge; and the proper proceeding for the Court of Appeals in the event that such factual findings do not appear with sufficient clarity. We consider that, as a preliminary step, an examination of the basic law applicable to the case will be of aid to this Court in its review.

The Construction of Section 23 (a) (2) of the Internal Revenue Code

This section of the Code was added by amendment in 1942, following the decision of this Court in *Higgins vs. Commissioner of Internal Revenue,* 312 US 212; 85 L ed 783. It is generally considered that the Higgins case was responsible for that amendment. *McDonald vs. Commissioner of Internal Revenue,* 323 US at 67; 87 L ed at 75 (dissenting opinion of Mr. Justice Black); Nahstoll, *Non-trade and Non-business Expense Deductions; Section 23 (a) (2) of the Internal Revenue Code,* 46 Mich. L. Rev. 1015, 1016, 1019 (June, 1948); *Marion A. Burt Beck,* 15 TC 642, 669.

This section of the Code provides for a deduction from gross income. The Court of Appeals in this case referred to this section as dealing with exemptions, and thus determined that under the doctrine of *New*

Colonial Company vs. Helvering, 292 US 435, 440, 78 L ed 1348, 1352, the statute should be strictly construed (R. 61). We do not consider that that standard is applicable.

In general, the Federal statutes taxing income are so devised that, on the surface at least, there appears a congressional intention to tax gross income, i.e., all income which may properly be taxed under the 16th amendment; and under such circumstances it is general law that statutes permitting exemptions or deductions should be strictly construed. (*Commissioner of Internal Revenue vs. Jacobson*, 336 US 28, 49; 93 L ed 477, 489). But the basic pattern which has been established for federal taxation of income (including numerous Congressional enactments of the type being considered here) has led thoughtful legal scholars and judges to a different conclusion. Mr. Justice Black, in his dissenting opinion in the case of *McDonald vs. Commissioner of Internal Revenue*, 323 US 57, 67; 89 L ed 68, 75, stated:

> "Taxation on net, not on gross, income has always been the broad basic policy of income tax laws. Net income may be defined as what remains out of gross income after substracting the ordinary and necessary expenses incurred in efforts to obtain or to keep it."

Nahstoll, *Non-trade and Non-business Expense Deductions*, 46 Mich. L. Rev. 1015, 1023, adopts Professor Griswold's statement in his note in 56 Harv. L. Rev. 1142, 1144-1145, ". . . there is no need . . . to deny that Congress has very great power over the deductions which are allowed. *The fact remains that Congress has never sought to tax gross income.* We are not dealing with a question of power, but of intention. And the whole structure and history of the income tax makes it plain

that the intention of Congress to allow deductions has been just as clear as its intention to tax income."

Furthermore, construction of this statute should take into account the fact that it was intended by Congress to remedy a defect in the law arising out of the interpretation of Section 23 (a) (1) given by this Court in the *Higgins* case (312 US 212; 85 L ed 783). It is a corrective and liberalizing provision, and should be so construed.

> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

Helvering vs. Bliss, 293 US 144, 150-151; 79 L ed 247.

Present pressures for revenues necessarily lead to unduly restrictive administrative and judicial interpretations of statutes permitting exemptions and deuctions, if the theory of strict construction of exemption statutes is applied without due consideration to (1) the general intendment of Congress to tax only net income, and (2) the determination that Congressional liberalizations of law in the taxpayer's favor are to be liberally construed. This is not a situation which begins and ends with this case. Liberalizing corrections and recorrections are becoming a necessary Congressional habit.

The Revenue Act of 1951 is studded with examples. Referring to the presently available Senate version, the following sections are of this general character: Section 339, page 38, Senate Report; Section 324, pages 41-42,

Senate Report; Section 325, pages 42-43 Senate Report; Section 323, pages 43-48 Senate Report; Section 343, pages 48-49 Senate Report; Section 317, pages 57-58 Senate Report; and Section 342, pages 63-65 Senate Report. Many others are liberalizations in favor of the taxpayer without reference to administrative or judicial construction of existing law, e. g. Section 318, page 34 Senate Report; Section 319, page 37 Senate Report; Section 309, pages 43-48 Senate Report; Section 312, page 48 Senate Report; Section 334, pages 49-50 Senate Report; Section 302, page 50 Senate Report; Section 328, page 50 Senate Report; Section 330, pages 50-51 Senate Report; Section 307, page 51 Senate Report; Section 303, page 52 Senate Report; Section 321, pages 52-53 Senate Report; Section 340, pages 53-54 Senate Report; Section 331, pages 54-55 Senate Report; Section 304, pages 59-60 Senate Report; Section 315, page 61 Senate Report; and Section 337, page 62 Senate Report.

Numerically, the loop-hole closing sections seem to have lost out to those which liberalize the income tax laws—a definite indication of the intention of Congress to insist on the taxation of some net-income result. At the very least, the rule that "exemptions . . . should be construed with restraint" (*Commissioner of Internal Revenue vs. Jacobson*, 336 US 28, 49, 93 L ed 477, 489), should be applied with restraint where Congress has specifically liberalized the exemption or deduction.

In enacting Section 23 (a) (2), the Congress went beyond the immediate problem generated by the *Higgins* case (312 US 212; 85 L ed 283). As Mr. Justice Black stated in his dissenting opinion in the case of *McDonald vs. Commissioner of Internal Revenue*, 323 US 57, 67; 89 L ed 68, 76: "The language (Congress) utilized was certainly far broader than was required to

meet the narrow problem presented by the *Higgins* case." Whether that broadening appears in the first phrase concerning the expense of producing income (Mr. Justice Black's view in the *McDonald* case) or in the all-inclusive language concerning the management, conservation, or maintenance of property (see Nahstoll, *Non-trade and Non-business Expense Deductions,* 46 Mich L Rev at 1023, and note 31) is relatively unimportant. The broad language of Section 23 (a) (2) and the circumstances and history of its enactment condemn such interpretations as—"The *Higgins* case . . . is a clearly defined example of the nature of the deduction for which Congress intended to provide" by the enactment of Section 23 (a) (2) (*Marion A. Burt Beck,* 15 TC 642, 669; see also, as to the capital expenditure feature, the discussion in Nahstoll, *Non-trade and Non-business Expense Deductions,* 46 Mich L Rev at 1024-1027).

Bingham's Trust vs. Commissioner of Internal Revenue, 325 US 365; 89 L ed 1670, is the key case which permits a meaningful interpretation of all of Section 23 (a) (2); and we contend that the logic of that case, appropriately applied to the instant one, necessarily results in the conclusion that the Court of Appeals erred in reversing the District Court—and in relying on *Cobb vs. Commissioner,* 173 Fed 2d 711 (CA, 6, 1949) in so doing.

Validity of Regulations 111, Section 29.23 (a) -15 (b)

The *Bingham* case (325 US 365, 89 L ed 1670) resulted in the amendment of the Regulations interpreting Section 23 (a) (2) by T. D. 5513, 1946 *Internal Revenue Bulletin 61,* approved May 14, 1946. As so amended the

regulation is included as appendix A to this brief. It includes the following limitation on the application of Section 23 (a) (2) on which the Court of Appeals relied in reversing the District Court (R. 61, 62):

> *"Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability* or even though, in event of a claim for refund, the amount received will be held by him for the production of income."

As the Court of Appeals apparently construed this phrase, it is an absolute prohibition of the deduction of expenses incurred by an individual if they are in any manner related to a gift tax controversy (R 62). This cannot be correct. On its face it is merely an *example* of a possible disallowance under those preceding paragraphs which are actually interpretive. It is like a law school examination question, necesarily implying the absence of other facts and circumstances. It is an aid in the interpretation of the statute, but is not an interpretation of the statute (as might be, for example, most of the first two paragraphs of subsection (b) of the regulation). Consequently, when the District Judge found, as we contend, that there were other facts and circumstances (R. 45, 46) which took this case out of the classification of an ordinary gift tax controversy, that example in the regulations was inapplicable, and decision of this case then must be determined by the words of the statute and those paragraphs of the regulations which are interpretative.

But considering, as did the Court of Appeals, that the phrase quoted from the Regulations has "the force

and effect of law" (R. 61) and so "denies the deduction here claimed" (R. 62), can the regulation, as interpreted to deny deductions for all expenses related to gift tax controversies, be valid? We contend that it cannot.

The law as determined by this Court does not permit such a regulation to stand. While certain examples may be used as guides in interpreting legislation, they cannot be considered as absolute determinations of factual situations, foreclosing a true judicial determination of whether the facts in a particular case do or do not meet the statutory requirement.

> "Undoubtedly, the regulation in terms declares that permanent loss of the use of one hand and one eye shall be deemed to be total permanent disability under an insurance policy such as that issued to petitioner. But the regulation is both inapplicable and invalid.
>
> * * *
>
> "It is invalid because not within the authority conferred by the statute . . . It is not, in the sense of the statute, a regulation at all, but legislation. * * * The vice of the regulation, therefore, is that it assumes to convert what in the view of the statute is a question of fact requiring proof into a conclusive presumption which dispenses with proof and precludes dispute. This is beyond administrative power.". *Miller vs. United States,* 294 US 435, 439-440, 79 L ed 977, 980-981.

To the same effect, *Waite v. Macy,* 246 US 606, 609; 62 L ed 892; and also *Busey v. Deshler Hotel Co.,* 130 F 2d 187, 190; 142 ALR 563.

Furthermore, the standard test set up by the Courts for the application of both Section 23 (a) (1) and Section 23 (a) (2) is: Is the expense directly

connected with *or* does it *proximately result* from the conduct of the business, the production of income, or the management, maintenance, or conservation of property held for the production of income?

> *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US at 374, 89 L ed at 1677.
>
> *Kornhauser vs. United States,* 276 US at 153, 72 L ed at 507.
>
> *Commissioner of Internal Revenue vs. Heininger,* 320 US at 471, 88 L ed at 175.

This test has been, substantially, adopted into the Regulations, which provide that "expenses, to be deductible under Section 23 (a) (2), must be 'ordinary and necessary,' which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income, or to the management, conservation, or maintenance of property held for the production of income." (Regulations 111, Section 29.23 (a) -15 (a), third paragraph).

This requirement of the proximity of the expense to the statutory objects of its use was first considered in one of the earliest cases in the Board of Tax Appeals, *Appeal of Sarah Backer,* et al, 1 BTA 214, 216. The Board there stated: "We are dealing here with the age-old question of *proximate cause.*" This phrase, long familiar to negligence practioners, has been variously defined.

> "'Legal or proximate cause is always dependent upon the facts of a particular case, and it is for this reason that the words are beyond definition or conclusive explanation'. This observation may account

in some degree for the widely varying concepts of proximate cause as revealed by examination of the cases."

1 *Shearman and Redfield on Negligence,* Revised Edition, page 94, Section 35; quoting Crane, J., in *O'Neill vs. City of Port Jervis,* 254 N.Y. 423, 433; 171 NE 694.

It is clear, however, that the disjunctive use of "direct" *or* "proximate" cause in the *Bingham* case (325 US at 374, 89 L ed at 1677) is appropriate. A result may be *indirect* but nevertheless proximate *(Aetna Insurance Co. vs. Boon,* 95 US 117, 130; 24 L ed 395, 399; *Miles vs. Van Hagen,* 128 P 2d 89, 92, District Court of Appeals, 2nd District, California, 1942). Consequently, the distinction of the Court of Appeals (R. 62) between a *proximate* and an *indirect* relationship is inappropriate.

Furthermore, the determination of proximity is essentially one of *fact,* to be settled by the trial court.

Bingham's Trust vs. Commissioner of Internal Revenue, 325 US at 370, 373, 376; 89 L ed at 1675, 1677, 1678.

Commissioner vs. Heininger, 320 US at 475, 88 L ed at 177.

Higgins vs. Commissioner of Internal Revenue, 312 US at 218; 85 L ed at 788.

But the Treasury Department's attempt, by the use of Regulations, to predetermine the factual results in cases such as the instant one, necessarily leads to the incongruous decisions referred to in the Harvard Law

Review note on *Cobb vs. Commissioner*, 173 F 2d 711 (CA, 6, 1949):

". . . although in one case the Tax Court relied on the lien theory in allowing the deduction by trustees of the cost of unsuccessful income tax litigation arising from payment of a bequest, see Mary Lily Bingham, 2 TC 853 (1943), the Supreme Court in affirming ignored the lien argument, reasoning that the expense was a 'proximate result' of the trustees' management duties in holding the trust property for the production of income. *Bingham's Trust v. Commissioner*, 325 US 365, 376 (1945), 58 Harv. L. Rev. 1254. Thus, it seems doubtful that the Court intended to sanction the argument, but subsequent courts ostensibly applying the 'proximate result' test summarily allowed income tax determination expenses on showings of proximity apparently no more substantial than that established by the taxpayer in the principal case. See, e.g., *Stoddard v. Commissioner*, 152 F. 2d 445 (2d Cir. 1945); 2 Tax L. Rev. 39, 59-64 (1946). Present treasury regulations accordingly permit the deduction of any expense of income tax determination, although they deny deductions for similar expenses connected with gift taxes; further, they expressly reject the lien theory. US Treas. Reg. 111, Paragraph 29.23 (a) -15 (1946). Ironically, although the Commissioner successfully denied the taxpayer in the principal case a deduction for his gift tax expenses, the cost of litigating that issue is deductible under the Regulations, since the controversy concerned income tax liability. Likewise, had the former determination not involved gift tax liability but validity of the gift for income tax purposes, i.e. whether income produced by the property which taxpayer transferred to his daughters was taxable to him, his expense would be deductible. In these cases, however, the contest is the result of a gift transaction and seems not to have resulted from the production of income, or the management or conservation of

property held for the production of income, to any greater extent than the determination in the *Cobb* case.

63 *Harvard Law Review* 358, December, 1949.

The Regulations, therefore, are not only invalid because they are legislative in character, but they are inconsistent within themselves, and hence not reasonable interpretations of the law.

In this regard we cite another example. Suppose that the Treasury Department had proceeded to collect the deficiency involved in the gift tax case from the *donees*, a procedure more likely to be followed if a donor gives away substantially all of his property. That alternative course could be taken by the Commissioner under Section 1009 of the Internal Revenue Code:

> "The tax imposed by this chapter shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift . . ."

The legal expenses of the *donees* in protecting the income-producing properties from the lien of a deficiency assertion would appear to fall exactly within the terms of the statute. They are not personal expenses under Section 24 (a) (1) of the Code, and to say that they in any way enhance the value of the donated property, so as to be capital expenditures, seems patently absurd. It is equally absurd to say that Congress intended that legal expenses resulting from gift tax controversies should or should not be allowable deductions depending on the whim of the Commissioner—that is, whether he chooses to assert tax deficiencies against the donor or the donees.

We respectfully urge this Court to condemn the regulation, insofar as it may be construed to disallow all expenses of gift tax controversies, as unauthorized by the statute and as an unwarranted and unreasonable interpretation thereof.

The Effect of a Determination on the Facts by the District Court

We have already referred generally to this Court's determination that the question of proximity is essentially a fact question on which the Trial Court should not be reversed, unless its decision was clearly erroneous. *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365, 370, 373, 376; 89 L ed 1670.

As we have pointed out in the Memorandum Brief in support of the petition for certiorari, in the instant case, the District Court did not make specific findings of fact, but wrote a Memorandum Decision ordering judgment for the plaintiff (R 44-49). Such memorandum decisions are "sufficient if the findings of fact and conclusions of law appear therein" *Federal Rules of Civil Procedure, Rule 52.* The Court of Appeals did not consider the District Court's findings, and, in effect, made findings of its own. We cannot, therefore, determine whether the Court of Appeals found the District Court's findings adequate. If they were not, then the Court of Appeals either:

(1) cannot act, because of a failure to present a reviewable question for determination *(Massachusetts Bonding Co. v. Preferred Automobile Ins. Co.,* 110 F 2d 764-CCA, 8, 1940), or

(2) must remand, so that "any action taken by the Court shall be upon findings of fact and conclusions founded upon the evidence, in ac-

cordance with Rule 52 (a) of The Rules of Civil Procedure".

Mayo v. Lakeland Highlands Canning Co., 309 US 310, 319, 84 L ed 774, 780; also, *Webster-Brinkley Co. v. Belfield*, 166 F 2d 814 (CCA, 9, 1948); *Public Service Commission v. Wisconsin Telephone Co.*, 289 US 68, 71; 77 L ed 1036, 1038.

Rule 52 applies to appeals by the Government, and its purpose is to avoid trials *de novo* in the appellate courts (*United States v. Yellow Cab Co.*, 338 US 338; 94 L ed 150); and it applies as well to inferences from undisputed testimony as to determinations of conflicting evidence; *Lowden vs. Hanson*, 134 F 2d 348, 351 (CCA, 8, 1943); *Stout v. Commissioner of Internal Revenue*, 185 F 2d 854 (CA, 6, 1950). It would, therefore, appear that unless the Court of Appeals was adopting the trial court's findings, it should have either dismissed the appeal or remanded the cause, particularly as its own statement of the facts is, in at least one instance, at variance with the record:

"*Opinion* (R 59): "The three children were unmarried and lived with plaintiff. Previous to the gifts, they had taken no active interest in the management of the corporation's affairs. Whether they did so thereafter, does not appear."

Testimony (R. 34-35):

"Q. Take your own son, for instance, Joseph T. Lykes, Jr., to whom you made gifts in 1940, did he follow what you thought he would and become identified with the Company?

A. He has been, since his release from the Navy, actively identified in the business, and has taken increased responsibility, and functioning as I had hoped he would.

Q. Does he also have any official connection with any of the business?

A. He is a Director today of both the parent company and the Steamship Company."

This testimony is on the important point of the non-personal aspect of the gift.

From the record and from the Memorandum Decision of the District Judge (see this brief, pp. 7-8), there appear several bases in the evidence for support of the ultimate fact that the expense in question was properly and proximately related to the management or conservation of income producing property, and not to a merely personal transaction (Internal Revenue Code, Section 24 (a) (1)) including: (1) the non-personal aspects of this particular gift, (2) the arbitrary and capricious act of a government agent as an efficient intervening cause between the gift and the legal expenses, (3) the payment of the legal fees, *not* for the successful conclusion of the gift tax case (which occurred two years later), but at the time of the deficiency assertion, and for relief against the immediate collection of the tax, and (4) the effect of that arbitrary and capricious act on the income producing property given and on that retained. In order to hold as it did, the Court of Appeals must have decided, contrary to the *Bingham* case, that the proximate relationship between the legal expenses and the management or conservation of income producing property is, in all cases involving

~~Tax Court. In *Nancy Reynolds Bagley*, 8 TC 130, the~~

gift taxes, a matter of law. The *Bingham* case makes no such exception, and we consider it unwarranted under the statute, the regulations, and the decisions of this Court."

We are not here encumbered with the doctrine of the *Dobson* case (*Dobson v. Commissioner of Internal Revenue*, 320 US 489, 88 L ed 248, 64 S Ct. 239); which was, in any event, substantially legislated out of existence in 1948 (Internal Revenue Code, Section 1141 (a); Section 36, Public Law 773, 80th Congress, 2nd Session). Subtracting that common consideration, it seems apparent that a basic distinction between the *McDonald* case (323 US 57, 64; 89 L ed 68, 74) and the *Bingham* case (325 US 365, 370; 89 L ed 1670, 1675) is that in the former case the Tax Court held *against* the taxpayer, while the decision of the Tax Court in the *Bingham* case was *in favor of* the taxpayer. In the *Bingham* case this Court clearly pointed out that:

(1) questions of reasonableness and proximity are for the trier of facts (325 US at 370; 89 L ed 1675).

(2) questions of law, as applicable to the instant case, involved only the determination of the meaning of "property held for the production of income" as used in the statute (325 US at 371, 89 L ed at 1675).

"The decisive question is whether the property ceased to be held for the production of income because, as the trust term reached its expiry date, the trustees were under a duty to distribute the property among the remaindermen." (325 US at 372; 89 L ed at 1676).

Even with regard to this question, this Court held that it should not "disregard the Tax Court's findings of fact" (325 US at 375; 89 L ed at 1677). Furthermore, this Court held that the distribution of income producing property from the trust there under consideration was consistent with the statutory function of its "management," and approved the Tax Court's determination that:

> "The costs of distribution here were quite as much expenses of a function of 'management' of the trust property as were expenses incurred in producing the trust income; and if 'ordinary and necessary'; they were deductible." (325 US at 375; 89 L ed at 1678)

The Court of Appeals in the instant case limited the application of the *Bingham* case on the theory that it related only to management functions of the trust estate which the trustees were under a *duty* to perform; whereas in the instant case the taxpayer had no *duty* to make the gifts (R 61-62). There is no warrant for that distinction in the statute. If a taxpayer had to prove that each expenditure which he made was the result of a *duty* which he had to perform there would be few allowable deductions under either Section 23 (a) (2) or Section 23 (a) (1).

As a matter of fact, there is no distinction in Section 23 (a) (2) between its application to a trust and to an individual. It is in terms applicable to an individual, and only by virtue of Sections 161 and 162 of the Code is it applicable to a trust (*Mary Lily Bingham Trust*, 2 TC 858; *Bingham's Trust v. Commissioner*, 325 US 365, 368; 89 L ed 1670, 1674). Thus, whatever this Court in the *Bingham* case said of the management of a trust is also true of the management of an individual's

income-producing fund of property, frequently referred to in ordinary parlance as his "estate".

Consequently, when this Court determines that "Section 23 (a) (2) thus treats the trust as an entity for producing income comparable to a business enterprice" (325 US at 374), it also determines that the individual's income-producing "estate" is a comparable entity.

Furthermore, if expenses in connection with the distribution of the trust corpus are deductible as expenses of the management of that income-producing property (325 US at 374, 375), so are expenses in connection with the distribution of the individual's income-producing "estate", regardless of whether he utilizes the mechanism of a trust to that purpose or the simpler mechanism of an *inter vivos* gift.

Under today's tax laws, the distribution of an individual's income-producing property is often a necessary function of his having such property. He can't take it with him; and *inter vivos* transfers are a recognized means of conserving the owner's total property. (For example, pages 136 through 151 of Trachtman's *Estate Planning*, 1949 edition, Practicing Law Institute, discuss *inter vivos* transfers.) The very property which was dealt with in the *Bingham* case was merely the subject matter of the ultimate distribution of an individual's income producing estate. The use of that more cumbersome method of distribution is not a distinction which can logically differentiate it from the instant case.

That "entity" concept of an individual's income producing property has been, in effect, adopted by the Tax Court. In *Nancy Reynolds Bagley*, 8 TC 130, the

taxpayer paid her attorneys a fee of $5000 for services rendered in connection with the "planning and rearrangement of her estate". "Among the changes made were the creation of certain inter *vivos trusts,* with income reserved to petitioner during her life, certain testamentary trusts, the cancellation of insurance policies, and the purchase of new insurance, etc." (at p. 133). She was allowed a deduction under Section 23 (a) (2) of the $5000 fee (at p. 135), despite the fact that many of these activities were merely preliminary to the ultimate result in the instant case, the disposition of income producing property.

We consider, of course, that the case of *Cobb vs. Commissioner,* 173 F 2d 711, was erroneously decided. The court based its decision, in part, on the following determination:

> "We are unable to adopt the impractical concept that giving away property produces income to the donor, or constitutes either management or conservation of the property." (at p. 715)

That, it seems to us, is a matter for the judgment of the taxpayer. A court should not attempt to determine the wisdom, or lack of wisdom, with which an individual manages his income producing property, and to determine whether a deduction occurring as an expense in that management is allowable or not on the basis of whether the taxpayer's management was wise or unwise. No such restriction appears in the statute and the courts have been justifiably reluctant to replace the managing judgment by which an individual holds or disposes of his property with their own.

The instant case is distinguishable from the *Cobb* case—not only on the basis of the different results obtained in the trial courts, but on the facts; and the ad-

ditional facts and circumstances in the instant case are amply sufficient to justify the different result obtained in the trial court. Utilizing the Memorandum Decision of the District Judge and entire record in support of that determination we find that the following considerations were present in this case:

1. The proximate cause of the legal expenses was not the gift, but the attempted assessment of a tax which was so clearly arbitrary and capricious that, in fact, it had nothing to do with the gift on which it was based (this brief, p. 7), and which thus neutralized any "personal" aspect of the gift.

2. The petitioner's (taxpayer's ultimate purpose in following a plan of giving was to further fortify his remaining interest in the company whose stock he gave. This policy proved to be sound (this brief, p. 7-8). It also made the gift non-personal.

3. The payment of counsel fees occurred at the time of the assertion of the gift tax deficiency, and was for the immediate relief of that situation, and not for the *successful* conclusion of the Tax Court case, which occurred two years later (this brief, p. 8).

4. Had the gift tax deficiency been successfully enforced, it would have substantially destroyed the donor's retained holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income (this brief, p. 7).

If we are dealing with "proximate cause" we must also recognize that there may be an efficient intervening cause (Cf. 1 *Shearman and Redfield on Negligence*, page 99, Section 37). We contend that the District Court found one in this case. The arbitrary and capricious assessment put the gift out of the picture and placed the Government in it. The legal expenses were still proximately related, however, to the management, conservation or maintnance of income producing property which had dictated the original gift, or to the retained income-producing property which had to be protected against the assessment. But, assuming the gift was a purely personal transaction, that personal aspect was neutralized by the arbitrary and capricious assessment. The proximate cause of the legal expenses (as distinguished from the proximate relationship between the legal expenses and the management or conservation of property) was no longer a personal transaction—a pure gift—but a fiscal battle between the taxpayer and the tax collector. Certainly no one can contend that litigation with one's Government is a "sport, hobby, or recreation", or otherwise classifiable as a purely personal pursuit. Internal Revenue Code, Section 24 (a) (1); Treasury Regulations 111, Section 29.23 (a) -15 (a), second paragraph. This is a consideration which should militate against classifying any expense of tax litigation as non-deductible (the conclusion of Nahstoll, *Non-trade and Non-business Expense Deductions*, 46 Mich. L. Rev. at 1030-1031); but it is especially cogent in this case.

The second consideration, that concerning the ultimate purpose of the gift, is an adequate answer to the contention of the *Cobb* case that giving is a purely personal pursuit. Giving is not always "impractical". Dis-

positions of property are often made with the idea of ultimately producing additional value in the retained property. To stigmatize all such transactions as impractical is to ignore the multitude of successful businessmen who have adopted one method or another of profit sharing in order to inspire managerial talent. That motive was present in the gift made in this case.

The effect of the gift tax assessment on the taxpayer's retained income producing property is one of degree. In the *Cobb* case the argument over the gift tax involved a relatively minor sum. In the instant case, $145,276.50 was involved (R. 45), a deficiency which, if successfully enforced, would have confiscated most of the taxpayer's (petitioner herein) income-producing estate (R. 46). It was the colossal size of this attack which required the defense, and its expense. It was not a result which a taxpayer might ordinarily have anticipated when making his gift. The Government, on the other hand, must have known, or should have known, that its activities against this taxpayer in 1944 were positive and unwarranted attacks against any income producing properties which he owned; and it should be held to the consequences of that knowledge. It should not be permitted to evade that issue because the excuse which it used to make its attack was a gift—even assuming contrary to fact, that the gift was a purely personal transaction.

CONCLUSION

It follows that the Court of Appeals has decided this case contrary to the applicable statute, Section 23 (a) (2) of the Internal Revenue Code, and in derogation of this Court's decision in *Bingham's Trust vs. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670 and other cases cited above; that the Regulations purporting to interpret that Statute, as they were construed by the Court of Appeals, are unauthorized and invalid; and the decision of the District Court was correct.

We, therefore, respectfully pray that the Court affirm the decision of the District Court and reverse the decision of the Court of Appeals.

Respectfully submitted,

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APPENDIX A

TREASURY REGULATIONS III

Section 29.33 (a)-15.

Nontrade or Nonbusiness Expenses.

(a) In general. Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building de-

voted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitation contained in section 24. Section 24 (a) (5) disallows any amount other-

wise allowable as a deduction (whether under section 23(a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23(a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or maintenace of property held for the production of such income is not deductible under section 23(a) (2). Nor does section 23(a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

Capital expenditures and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23(a (2) are the following: Commuters' expenses;

expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a)(2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer of such investment.

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration

expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's right's to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenses paid or incurred by an individual in the determination of liabil-

ity for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7). Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other

section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof. (Amended by T.D. 5331, approved Feb. 9, 1944, and by T.D. 5513, approved May 14, 1946.)